APPENDIX

Statute and Regulations Involved

Revenue Act of 1932, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

* * * * *

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 193. *Uncollectible deficiency upon sale of mortgaged or pledged property.*—Where

mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. In addition, where the creditor buys in the mortgaged or pledged property, loss or gain is realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only when it has previously been returned as income.

U. S. GOVERNMENT PRINTING OFFICE: 1941

No. 674.

Office - Supreme Court, U. S.
FILED
NOV 1 1941
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

WEST PRODUCTION COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY MEMORANDUM FOR PETITIONER.

ROBERT ASH,
Munsey Building,
Washington, D. C.,
Attorney for Petitioner.

October 31, 1941.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

TABLE OF CASES CITED.

Page

Alabama Asphaltic Limestone Co., Helvering v., No. 328 this term 1, 4

Bondholders Committee, etc. v. *Helvering*, No. 128 this term 1, 3

Le Tulle v. *Scofield*, 308 U. S. 415..... 2

Marlborough House, Inc. v. *Helvering*, No. 129 this term 1

Midland Mutual Life Insurance Co., Helvering v., 300 U. S. 216 5

New President Corporation v. *Commissioner*, ¶62,831 Prentice-Hall 4

Palm Springs Holding Company v. *Helvering*, No. 503 this term 1, 4

Piper, Eugene T., 45 B. T. A. No. 49, ¶64,887 Prentice-Hall 5

Southwest Consolidated Corporation, Helvering v., No. 286 this term 3

Tyng, Helvering v., 308 U. S. 527..... 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 674.

WEST PRODUCTION COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY MEMORANDUM FOR PETITIONER.

I.

In the "Brief for the Respondent in Opposition" the statement is made, referring to *Bondholders Committee etc.* v. *Helvering* and *Marlborough House. Inc.* v. *Helvering*, Nos. 128 and 129; *Helvering* v. *Southwest Consolidated Corporation*, No. 286; *Helvering* v. *Alabama Asphaltic Limestone Co.*, No. 328; and *Palm Springs Holding Co.* v. *Helvering*,

No. 503 (certiorari granted in each case October 13, 1941), that (p. 5):

> "In none of these cases is this Court required to decide whether, if the transactions did not constitute a reorganization, the new company must use as its basis the bid price or the fair market value on the date of acquisition."

The above quoted statement is in conflict with the statements filed in behalf of the Government in the five cases mentioned.

In each of those cases, as is hereinafter set forth, there are two questions:

(1) Where bondholders or creditors buy in the debtor's property at foreclosure is there a "reorganization," and

(2) What is the basis of the property thus bought in.

In view of *Le Tulle* v. *Scofield,* 308 U. S. 415, and *Helvering* v. *Tyng,* 308 U. S. 527, this Court will probably agree with the Government that there was no reorganization. That being true, the remaining situation will be identical with the situation in the case at bar, *i. e.,* creditors will have bought in assets at a foreclosure sale.

If this Court adopts the Government's contentions on this point, it will hold that the bid price establishes the basis for depreciation and gain or loss on sale. Such is the established law as referred to at page 6 of the petition herein. The rule, naturally, will be of general application and will control over the Treasury Regulations to which the Government refers on page 7 of its brief. Consequently if the Government wins the cases referred to, the rule established will govern this taxpayer. While this Court has the question before it in the cases mentioned, it should grant the writ and decide this case, as this case is inseparably joined with the cases in which certiorari has been granted.

The following short discussion shows that the Government has stated to this Court that one of the principle issues in the said cases is the basis for depreciation of assets bought at foreclosure.

In Nos. 128 and 129, *Bondholders Committee etc.* v. *Helvering* and *Marlborough House, Ins.* v. *Helvering* (certiorari granted October 13, 1941), the Circuit Court of Appeals sustained the Commissioner and held

(1) That the purchase of assets by a bondholders committee was not a "reorganization" and

(2) That the basis of the assets acquired was the bid price.

The Government stated it believed the case was correctly decided by the Court below and did not oppose the granting of certiorari, stating (p. 2):

> "The question is the basis for depreciation • • • of corporate assets bought in at equity foreclosure sale by a bondholders' committee."

In No. 286, *Helvering* v. *Southwest Consolidated Corporation*, the Fifth Circuit decided against the Government, holding:

(1) That the purchase by a bondholders' committee at a foreclosure sale was a "reorganization" and

(2) That the basis of the assets was the cost to the predecessor corporation, or $8,995,724.91.

The Government contends before this Court that the basis of the assets is not the cost to the predecessor corporation, or the fair market value, ($1,766,694.98), but the bid price of $752,000.00.

In its petition in the *Southwest* case, the Government claims the Circuit Court of Appeals erred (p. 5):

> "In failing to hold that the basis of the assets was their cost to the bondholders' committee at the foreclosure and receivership sales."

No. 328, *Helvering* v. *Alabama Asphaltic Limestone Company,* involves a situation where a creditors' committee bought in the corporation's assets at bankruptcy sale. The Government's petition states (p. 4):

> "In computing its depreciation and depletion allowances for the year 1936, the taxpayer treated its assets as having the same basis that they had in the hands of the old corporation. The Commissioner, in determining the deficiency, used the cost of the assets to the committee as their basis; namely, the price paid at the bankruptcy sale. The Board of Tax Appeals rejected the commissioner's position, and the Court below affirmed."

The Government then alleges the Circuit Court of Appeals erred (p. 5):

> "In failing to hold that the basis of the assets was the cost to the creditors' committee at the bankruptcy sale."

It is interesting to note that in No. 328 the petition, on pages 5 and 6, refers to *Commissioner* v. *New President Corporation* (¶62,831 Prentice-Hall) wherein the Eighth Circuit overruled the Commissioner's determination that the bid price governs. Obviously, the Commissioner has consistently held, as the Government in these cases contends, that the bid price governs. If it governs in other cases, it obviously should govern in the case at bar. It should be parenthetically stated that counsel was informed by representatives of the Department of Justice that the Solicitor General authorized the filing of a petition for certiorari in the *New President* case. After the petition in the case at bar was filed, the said authorization was withdrawn.

In No. 503, *Palm Springs Holding Corporation* v. *Helvering,* the petitioner is a corporation formed by a bondholders' committee. The Committee bid in certain property at foreclosure sale. The Government's "Memorandum for Respondent" states (p. 2):

> "The question presented is whether the taxpayer may take as its basis for depreciation the basis of these assets in the hands of the Palm Springs Hotel Company and the Palm Springs Hotel Operating Company. The Court below sustained the Commissioner's determination that the basis for depreciation was the cost of the property at the foreclosure sale."

The foregoing clearly shows that the Government consistently sought certiorari in these cases so that this Court might determine the basis of assets purchased at foreclosure. Certiorari should issue in the case at bar so that the Court may decide the entire question and eliminate controversies which are bound to arise if the writ is not granted.

II.

The brief in opposition contends that this case is not in conflict with *Helvering* v. *Midland Mutual Life Insurance Co.*, 300 U. S. 216, discusssed at pp. 7-8 of the petition. In that case this Court decided for the Government and squarely held that:

> "A mortgagee who, at foreclosure sale, acquires the property pursuant to a bid of the principal and accrued interest is, as purchaser and grantee, in a position no different from that of a stranger who acquires the property on a bid of like amount."

The Government's brief in the case at bar argues that there is no conflict because in the *Midland* case an insurance company was involved. We have not reached the point where the very same act by an oil producing company and an insurance company has different legal consequences. It is certainly true that the Bureau of Internal Revenue has been giving the doctrine of the *Midland* case general application and has not limited it to insurance companies. As recently as October 7, 1941, the Board of Tax Appeals upheld the Commissioner's contention that the *Midland* case had general application. See *T. Eugene Piper*, 45 B. T. A. No. 49, ¶64,887 P-H.

III.

In this case the taxpayer bought notes, the notes became in default, and in order to protect its investment, the taxpayer had to buy in the security behind the notes at foreclosure. The sale was a midway and unexpected step in the entire transaction. When the assets are disposed of, the transaction will be completed. If you made an investment in a note and had to buy in the security in an effort to save something out of the venture, would you say that the purchase of the assets was the end of a transaction entered into for profit? Actually, it might be a step near the beginning, rather than the end, as it might take years to sell the security and clean up the whole transaction. Yet, the Government's brief ignores realities and states (p. 8):

> "The acquisition of the property at foreclosure sale in this case was not the beginning of a transaction; on the contrary it was the end of a transaction entered into for profit."

If an investor had many deals like this, and was compelled to bear a tax burden when the security was reduced to possession, he might find himself with no cash to pay taxes or carrying charges and be insolvent. Such a determination of "income" ignores reality.

IV.

The Government's brief makes no mention of the fact that the regulation which is the basis of the decisions below is founded on the loss section of the statute and is invalid. (See pp. 9-11 of petition.) At page 7 the respondent's brief argues that this transaction comes within Sec. 111 (b) of the Act dealing with *sales*. Such an argument is another illustration of ignoring reality. This taxpayer did not sell anything. All it has done is pay out. There is no statutory authority for taxing such outgo.

CONCLUSION.

Certiorari should issue to enable this Court to straighten out the present confusion surrounding purchases at foreclosure.

ROBERT ASH,
Munsey Building,
Washington, D. C.,
Attorney for Petitioner.

October 31, 1941.